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STATEMENT OF

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on

**THE COMMUNITY REINVESTMENT ACT:
THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN**

before the

**FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES**

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2128 Rayburn House Office Building**

Chairman Frank, Ranking Member Bachus and members of the Committee, thank you for the opportunity to testify today on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the Community Reinvestment Act (CRA)¹ on the occasion of the thirtieth anniversary of the Act. CRA was landmark legislation and its effect has been significant in enhancing credit opportunities nationwide.

In my testimony, I will provide some brief background on the statute and regulation, discuss how the FDIC evaluates and monitors CRA performance, explain the effect of CRA on the financial institution application process and describe CRA's positive impact. I also will focus on how the FDIC is using CRA to address current challenges, such as mortgage foreclosures, the need for affordable small-dollar loans, the exceptionally high cost of credit and the need for basic banking services in many underserved communities.

Background

Before CRA was enacted in 1977, there were severe shortages of credit available to low- and moderate-income neighborhoods, as well as concerns about redlining² and discrimination. CRA was intended to expand access to credit and reduce discriminatory credit practices. The statute built on earlier legislation such as the Home Mortgage

¹ Codified at 12 U.S.C. § 2901 *et seq.*

² "Redlining" is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Interagency Fair Lending Examination Procedures, incorporated in the FDIC Compliance Examination Handbook, <http://www.fdic.gov/regulations/compliance/handbook/html/chapt04.html>.

Disclosure Act of 1975 (HMDA), the Equal Credit Opportunity Act in 1974 and the Fair Housing Act in 1968. Consistent with safe and sound operations, CRA assigns federally insured financial institutions a "continuing and affirmative" obligation to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods.³

Evolution of CRA Regulations

In the thirty years since CRA's passage, there have been significant changes in the financial services sector in terms of both industry characteristics and available products. The agencies have revised the CRA regulations over time to keep pace with financial sector developments.

The original implementing regulations for CRA, issued by the agencies in October 1978, established criteria for evaluating bank and thrift CRA performance.⁴ Public evaluations provided narrative descriptions of financial institutions' efforts, but with few hard numbers to support the examiners' conclusions. The emphasis in the original regulations was on process, and the same performance criteria were used to evaluate all banks and thrifts regardless of size or business focus.

³ See 12 U.S.C. § 2901(a).

⁴ These criteria included: the ascertainment of community credit needs, marketing and type of credit extended; the geographic distribution and record of opening and closing branches; discriminatory and other illegal credit practices; and community development needs and efforts. The examination procedures considered thirteen subcategories under these broad concepts. See 43 Fed. Reg. 47144, 47152 (Oct. 12, 1978).

Over time, these regulations were criticized by both industry and community groups for an over-reliance on process to the detriment of actual performance. In response, the agencies amended the CRA regulations in May 1995 to require that an institution's CRA activities be evaluated against the institution's performance context, taking into account both economic and demographic information about the institution's assessment area and the available lending, investment, and service opportunities. In response to growing specialization within the banking industry, the revised regulations provided separate tests for large retail, small retail, and wholesale/limited purpose institutions,⁵ and incorporated an option for banks and thrifts to include the activities of their affiliated companies in their CRA exams.

When the agencies issued the revised regulations in May 1995, they committed to review the regulations again within 10 years. With the considerable changes in the financial services sector over that time, a number of potential revisions were considered. After an advanced notice of proposed rulemaking and several subsequent notices of proposed rulemaking, the agencies issued final rules in 2005.⁶ These rules included a number of revisions, including clearer consideration of discriminatory or other illegal credit practices, which I will address in more detail later in my testimony when I discuss how illegal lending is incorporated in the CRA review.

⁵ The 1995 revisions to the regulations implementing CRA defined "large banks" as those having assets of \$250 million or more or affiliated with a holding company controlling banking assets of \$1 billion or more. Per revisions in 2005, "large banks" currently are banks having assets equal or greater than \$1.061 billion (due to an inflationary adjustment), with banks below that threshold classified as "small banks" or "intermediate small banks." *See* 12 C.F.R. § 345.12(u). Limited purpose banks offer only narrow product lines such as credit cards. *See* 12 C.F.R. § 345.12(n). Wholesale banks are not in the business of offering home mortgage, small business or farm, or consumer loans to retail customers, but do not meet the criteria for being a limited purpose bank. *See* 12 C.F.R. § 345.12(x). A bank must apply for and receive approval of either a wholesale or limited purpose designation. 12 C.F.R. § 345.25(b).

⁶ 70 Fed.Reg. 44256, 44269 (Aug. 2, 2005).

Over the years since promulgation of the original CRA implementing regulations, the agencies have periodically issued a series of interagency CRA questions and answers (CRA Q&As) designed to give further guidance to examiners and bankers.⁷ Most recently, in July 2007, the agencies issued for public comment proposed revisions of the existing CRA Q&As and addressed a number of emerging issues.⁸ For example, the proposed revisions highlight that establishing loan programs to provide relief for low- and moderate-income homeowners facing foreclosures will warrant favorable consideration as being responsive to the needs of the institution's assessment area. Other proposed changes encourage institutions to support national foreclosure relief programs and counseling. The agencies expect to issue the final revised CRA Q&As in the upcoming weeks.

FDIC's CRA Review and Evaluation Process

Consistent with statutory requirements, FDIC examiners evaluate the CRA performance of the approximately 5,200 institutions under the Corporation's supervision.⁹ As I noted above, for most institutions, this performance is evaluated under tests that draw distinctions among institutions based on their size and business

⁷ See, e.g., 12 C.F.R. Part 345; 66 Fed.Reg. 36620 *et seq.* (July 12, 2001).

⁸ 72 Fed. Reg. 37922 (July 11, 2007).

⁹ As with consumer compliance examinations, an institution's size and examination history determine the frequency with which its CRA performance is evaluated. The CRA frequency schedule incorporates limits imposed by the Gramm-Leach-Bliley Act of 1999 on CRA evaluations of small institutions, i.e., currently those with \$250 million in assets or less, that have previously received strong CRA ratings. See 12 U.S.C. §2908. There are 30 special purpose banks supervised by the FDIC that are not subject to CRA requirements. These institutions do not perform commercial or retail banking services by granting credit to the public in the ordinary course of business. 12 C.F.R. § 345.11(c)(3). An institution must apply for and receive approval for such a designation.

strategies.¹⁰ When conducting CRA evaluations, examiners consider factors such as the business opportunities available, as well as the size and financial condition of institutions.¹¹

Lending institutions with assets greater than \$1.061 billion (adjusted annually for inflation) are subjected to a three-part lending, services and investment test that evaluates both their retail and community development activities.¹² The lending test evaluates a bank's record of helping to meet the credit needs of its assessment areas by considering a bank's home mortgage, small business, small farm, and community development lending. The investment test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s). The services test analyzes both the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services.¹³

Small banks are evaluated under a test that focuses on their lending performance. The test encompasses the following five criteria: a "reasonable" loan-to-deposit ratio; the percentage of loans in the bank's assessment area; the bank's distribution of loans to individuals of different income levels and to businesses and farms of different sizes; the

¹⁰ All institutions may develop their own strategic plans to fulfill CRA responsibilities, subject to public comment and agency approval. *See* 12 C.F.R. §§ 345.21(a)(4) and 345.27.

¹¹ *See* FDIC Compliance Handbook, Chapter XI (Community Reinvestment Act), <http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html>.

¹² *See* 12 C.F.R. § 345.21(a)(1).

¹³ *See* 12 C.F.R. § 345.21(a) and §§ 345.22-345.24.

geographic distribution of loans; and the bank's record of responding to written complaints about its lending performance in its assessment area.¹⁴ Most FDIC-supervised institutions qualify as small banks under CRA.

In recent years, the FDIC and the other banking regulators established a streamlined examination for "intermediate small banks" (ISBs).¹⁵ ISBs are evaluated under the five-part small bank lending test, and a flexible community development test.¹⁶ The community development test scrutinizes the amount and responsiveness of an ISB's community development lending, investing, and services.¹⁷ This approach was intended to permit ISBs to make use of a flexible combination of community development activities tailored to both the needs of the community and the capacity of the bank.¹⁸ ISBs are required to achieve satisfactory ratings on both the lending and the community development test to receive an overall CRA rating of "Satisfactory."¹⁹

Wholesale and limited purpose banks are subject to a community development test that considers community development loans, community development services, and qualified investments. All banks have the option of developing a strategic plan for meeting their CRA responsibilities, subject to public comment and approval by the FDIC.

¹⁴ See 12 C.F.R. § 345.26(b).

¹⁵ ISBs were initially defined as institutions with assets of \$250 million to \$1 billion. With the annual adjustments for inflation, ISBs currently have assets that range between \$265 million and \$1.061 billion. *Id.* at § 345.12(u)(1).

¹⁶ See 12 C.F.R. § 345.26(a)(2).

¹⁷ See 12 C.F.R. § 345.26(c).

¹⁸ See 70 FR 44256, 44259-60 (Aug. 2, 2005).

¹⁹ See 12 CFR § 345, Appendix A at (d)(3)(i).

CRA Performance Context and Data Used by Examiners

An institution's performance under all of the relevant CRA tests is judged in the context of information about the institution and its community, competitors, and peers. Examiners consider: (1) the economic and demographic characteristics of the assessment area(s); (2) lending, investment, and service opportunities in the assessment area(s); (3) the institution's product offerings and business strategy; (4) the institution's capacity and constraints; (5) the prior performance of the institution and, in appropriate circumstances, the performance of similarly situated institutions; and (6) other relevant information.²⁰ Advances in technology and the availability of various economic, demographic and business data through private and public sources greatly assist examiners as they evaluate an institution's performance context.

In addition, large banks must report information about their small business, small farm, and community development loans.²¹ If a bank reports data under HMDA,²² examiners can consider the institution's historical mortgage loan performance as well as its performance against other market participants, including the performance of other federally supervised institutions and independent mortgage companies. In the absence of HMDA or other reported data, examiners sample an institution's home mortgage, small

²⁰ See 12 C.F.R. § 345.21(b).

²¹ See 12 C.F.R. § 345.42.

²² HMDA reporting requirements apply to depository institutions that have a home or branch office in a metropolitan statistical area (MSA), originate at least one home purchase loan or refinancing loan secured by a first lien on a one-to-four family dwelling, and, for the reporting of 2008 HMDA data, had total assets of more than \$37 million at the end of 2007. See 12 C.F.R. § 203.2(e)(1). Many non-depository mortgage lenders also are required to report HMDA data. Only about 54 percent of the banks supervised by the FDIC are required to report HMDA data. The remaining banks are not required to submit HMDA data either because their assets are below the threshold for HMDA filing or they are not located in a metropolitan area.

business, small farm, and community development loans, as applicable. Consumer loans are also sampled if the institution requests that they be reviewed or if they represent a substantial majority of the institution's business.

CRA Performance Evaluation

Upon the conclusion of each examination, the examiner prepares a written evaluation of the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.²³ The FDIC and other financial institution regulatory agencies facilitate public review of CRA evaluations by posting them on their Internet websites, and institutions must make them available to the public.²⁴

Each CRA evaluation must contain the institution's rating and a statement describing the basis for the rating.²⁵ While the content of the public evaluation varies depending on the nature of the institution examined and the assessment method used, the public portion of the evaluation generally contains the following information:

- The institution's CRA rating;
- A description of the financial institution;
- A description of the financial institution's assessment area; and
- Conclusions regarding the financial institution's CRA performance, including the facts, data, and analyses that were used to form such conclusions.²⁶

²³ See 12 U.S.C. §2906(a)(1).

²⁴ See 12 U.S.C. §2906(a)(2).

²⁵ See 12 U.S.C. §2906(b)(1)(iii).

²⁶ See FDIC Compliance Handbook, Chapter XI (Community Reinvestment Act Performance Evaluation Templates), <http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html>.

Nature and Effect of CRA Ratings

The agencies assign each institution one of four performance ratings:

“Outstanding,” “Satisfactory,” “Needs to Improve,” and “Substantial Noncompliance.”²⁷

Determining the CRA rating for an institution involves an assessment of a number of qualitative and quantitative factors against the backdrop of the institution’s performance context. To foster consistency in this process, the agencies rely on a matrix which sets forth a description of the elements of the various tests and what performance level is required for each of the ratings.²⁸

In 2007, the FDIC conducted 1,017 CRA examinations. Of these, 55 received an “Outstanding” rating, 944 received a “Satisfactory” rating, 14 received a “Needs to Improve” rating, and four received a “Substantial Noncompliance” rating.²⁹ Because of the strong incentives offered by CRA, few institutions receive a “Needs to Improve” or “Substantial Noncompliance” rating. In the past six years, the FDIC has assigned these ratings a total of 89 times, to 63 institutions. One of these institutions received a “Substantial Noncompliance” rating for each year, while another five institutions were rated “Needs to Improve” or “Substantial Noncompliance” 3 or 4 times in a row. Of these 63 institutions, seven had assets of over \$1 billion, and 21 had assets between \$250 million and a billion. Fifteen had assets between \$50 million and \$250 million, and 21

²⁷ See 12 U.S.C. § 2906(b)(2).

²⁸ See 12 C.F.R. § 345, at Appendix A (FDIC publication of ratings matrix used by all of the financial institution regulatory agencies.)

²⁹ These figures are for performance evaluations conducted in 2007 for which a rating has been assigned. Performance evaluations are made public three months after receipt by the financial institution, to allow the opportunity for a supervisory appeal. Therefore the exact number of each type of rating could change.

had assets of less than \$50 million. Although some of these banks are located in metropolitan areas, one-third are located in rural areas.

The Effect of Fair Lending Violations on CRA Ratings

Consistent with interagency regulatory guidance, discriminatory or other illegal credit practices, including violations of the fair lending laws, are considered when evaluating CRA performance and may result in a lower CRA rating. The FDIC regulation covering discriminatory or other illegal lending practices, as amended in 2005, states that:

The FDIC's evaluation of a bank's CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank or in any assessment area by any affiliate whose loans have been considered as part of the bank's lending performance.³⁰

Evidence of discriminatory or other illegal credit practices considered as part of the CRA evaluation includes, but is not limited to:

- discrimination against applicants on a prohibited basis in violation, for example, of the Equal Credit Opportunity Act or the Fair Housing Act;
- violations of the Home Ownership and Equity Protection Act;
- violations of section 5 of the Federal Trade Commission Act;
- violations of section 8 of the Real Estate Settlement Procedures Act; and

³⁰ 12 C.F.R. § 345.28(c)(1).

- violations of the Truth in Lending Act provisions regarding a consumer's right of rescission.³¹

The 2005 amendments strengthened the CRA regulations in several respects. First, they expressly incorporated into the regulation the examples of discriminatory or other illegal credit practices cited above. Second, the amendments clarified that discriminatory or other illegal credit practices carried out by the institution under review in any geography could be adversely considered by the regulators. This part of the amendment made clear that the agencies could consider lending discrimination that had occurred outside an institution's CRA assessment area.³² Finally, the amendments added express coverage of discriminatory or other illegal credit practices by an affiliate within the institution's assessment area if the relevant lending was considered as part of the institution's CRA performance evaluation.

The effect of an illegal credit practice by an institution is determined in the overall context of the institution's CRA performance. The FDIC's regulation, substantively identical to the other regulators', states that in determining the effect of evidence of such practices on the bank's assigned rating:

the FDIC considers the *nature, extent, and strength* of the evidence of the practices; the policies and procedures that the bank . . . has in place to prevent the practices; any corrective action that the bank . . . has taken or has committed to take, including voluntary corrective action

³¹ *Id.*

³² Under the CRA regulations, a bank chooses one or more assessment areas within its geographic regions which the FDIC uses to evaluate the bank's record of helping to meet the credit needs of its community. See 12 C.F.R. § 345.41.

resulting from self-assessment; and any other relevant information.³³

In order to determine the impact of an illegal credit practice on an institution's CRA rating, examiners follow a deliberative process. First, they use interagency examination procedures³⁴ to assign a preliminary CRA rating based in the performance tests described earlier. Examiners then review the results of the institution's most recent compliance examination, which includes the fair lending review, to determine whether evidence of discriminatory or other illegal credit practices has been found. If that is the case, examiners consider the nature, extent, and strength of the evidence, as required by the regulation. Through this analysis, they determine the extent to which illegal credit practices will affect the institution's CRA rating.

For FDIC-supervised institutions evaluated between January 1, 2002 and September 30, 2007, fair lending violations resulted in 14 CRA rating downgrades: three downgrades to "Satisfactory", and eleven to "Needs to Improve." We are considering similar action with respect to several other CRA ratings currently under review. Depending upon the nature and extent of evidence of any discriminatory or other illegal credit practice discovered by our examiners, the FDIC may accelerate the CRA examination cycle to consider the impact of the practice on the bank's CRA rating.

³³ 12 C.F.R. § 345.28(c)(2) (emphasis added)

³⁴ These procedures have been incorporated into the FDIC Compliance Handbook at Chapter XI (Community Reinvestment Act), <http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html>

CRA Enforcement -- the Applications Process

In contrast to fair lending violations, which can be addressed through mandatory corrective action and financial penalties, CRA is enforced through the applications process and the public disclosure of ratings. The CRA rating is required to be a factor in the supervisory agency's review and approval of the institution's application to expand its business by opening a branch, relocating a home office, merging with or acquiring another institution,³⁵ as well as in the review of an application for deposit insurance for a proposed new institution. Poor CRA ratings or negative public comments can slow down or halt the processing of an application important to an institution's growth and business activities.

In evaluating all these applications, the FDIC must take into account the applicant institution's CRA performance or, in the case of a new institution, its proposed CRA plan, as well as the views expressed by any interested parties about an institution's CRA performance. To facilitate public comment, the FDIC maintains a publicly available database of all applications subject to the CRA, and commenters have between fifteen and thirty days to submit comments, depending on the type of application.³⁶

The FDIC can deny or conditionally approve applications based on CRA concerns identified either through public comment or the supervisory review process.³⁷ Many

³⁵ See 12 C.F.R. § 345.29.

³⁶ Applications Subject to the Community Reinvestment Act and Public Comment, <http://www2.fdic.gov/cra/>. See 12 C.F.R. §§ 303.23, 303.44, 303.65 and 303.86.

³⁷ See 12 C.F.R. § 345.29(d).

situations are resolved through a commitment by the applicant to undertake or refrain from certain activities. In some circumstances, no resolution is possible. Before FDIC staff recommends denial, however, the applicant is informed of the likely negative outcome and offered the opportunity to withdraw the application and thereby avoid a likely denial by the FDIC Board of Directors.³⁸

In light of this process, many applicants withdraw their applications, and as a result, denied applications are extremely rare. In the last ten years, the FDIC has not denied any applications as a result of CRA ratings or comments. As an example, of the over 2,400 deposit insurance applications received in the last ten years, 20 percent were withdrawn, and in 14 of these applications the FDIC noted CRA performance deficiencies. In the same time period, the FDIC received close to 20,000 branch and merger applications.

Maintaining the Quality of the Examination Process

The FDIC follows a number of procedures designed to promote accuracy and consistency in the CRA evaluation process. Before examiners are permitted to lead a CRA performance evaluation, they must complete a commissioning process which includes specialized CRA training. Extensive written guidance is available to examiners as they prepare performance evaluations. Once evaluations are written, the evaluations are subject to supervisory review before they are finalized and published. In addition, we

³⁸ Only the FDIC Board of Directors may deny an application.

periodically conduct field and regional office reviews that sample and assess the quality of performance evaluations that have already been issued.

The FDIC continually assesses its efforts to achieve consistency and accuracy in CRA evaluations and to adjust and expand procedures as warranted. This is an ongoing process and we have received valuable insights in this regard from consumers and industry, as well as from periodic reports by the Government Accountability Office (GAO) and from the FDIC's Office of Inspector General (OIG).

As I noted earlier, criticism about the undue focus on process prompted the 1995 regulation changes to increase regulators' attention to performance. That same year, the GAO reviewed the examination processes at all the agencies and made a number of recommendations for improvement, including developing more comprehensive training for examiners, focusing increased attention on data accuracy, and revising the presentation of information in performance evaluations to improve clarity.³⁹ The agencies implemented enhancements responding to the recommendations as they implemented the revised regulations. In response to recommendations by the FDIC OIG in 2000 and 2007,⁴⁰ the FDIC provided additional specific guidance to examiners relating to presentation of data and support for conclusions. The FDIC also provided further

³⁹ GGD-96_23 (Nov. 1995), GAO Report *Community Reinvestment Act: Challenges Remain to Successfully Implement CRA*. <http://www.gao.gov/archive/1996/gg96023.pdf>.

⁴⁰ Audit of the Division of Compliance and Consumer Affairs' Community Reinvestment Act Examination Process, OIG Audit Report 00-026 (July 7, 2000), <http://www.fdicig.gov/reports00/00-026.pdf>; FDIC's Implementation of the 2005 Amendments to the Community Reinvestment Act Regulations, OIG Audit Report 07-008 (March 30, 2007), <http://www.fdicig.gov/reports07/07-008.pdf>.

direction to supervisors who review performance evaluations, in order to improve the consistency of performance evaluations.

The Positive Impact of CRA

Studies have pointed to increases in lending to low- and moderate-income customers and minorities in the decades since the CRA's passage. For example, a study by the Joint Center for Housing Studies at Harvard University reported that HMDA data for 1993 through 2000 show that home purchase lending to low- and moderate-income people living in low- and moderate-income neighborhoods grew by 94 percent -- more than in any of the other income categories.⁴¹

In a GLBA-mandated study of the performance and profitability of CRA-related lending activities published in 2000 by the Federal Reserve Board, most of the institutions responding reported that CRA-related mortgage lending tended to be either profitable or marginally profitable.⁴² The study also indicated that often origination and servicing costs for CRA-related mortgage lending were not dissimilar to those for other loans.⁴³ In addition, almost all respondents reported that their CRA-related small

⁴¹ *The Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*, The Joint Center for Housing Studies, Harvard University, March 2002.

⁴² The Performance and Profitability of CRA-Related Lending Report by the Board of Governors of the Federal Reserve System, Submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000, at v.

⁴³ *Id.* at vii.

business lending was either profitable or marginally profitable, and four percent reported that it was more profitable than non-CRA small business lending.⁴⁴

CRA encourages banks to participate in innovations and to adopt new lending opportunities, consistent with safe and sound lending practices. According to the GLBA study, “Nearly two-thirds of respondents report that their CRA-related home purchase and refinance lending has led to such opportunities.”⁴⁵

Over its history, CRA has made a significant contribution to the revitalization of many low- and moderate-income communities in both urban and rural areas, and has changed the way banks approach lending in their communities. However, more remains to be done.

The Role of CRA in Addressing Current Challenges

CRA, as passed in 1977, provides flexibility because it contains broad goals without detailed requirements about how to achieve them. With its focus on the needs of the community as opposed to specific products or services, it allows bankers to alter their offerings in response to changing credit demands. It also allows federal bank and thrift regulatory agencies to address emerging issues and respond quickly to local and national crises. For example, to help stabilize and revitalize the Gulf Coast communities in the

⁴⁴ *Id.* at xxi.

⁴⁵ *Id.* at xii.

aftermath of Hurricanes Katrina and Rita, the agencies provided CRA credit for all institutions for recovery-related loans and investment.

Today, the FDIC is promoting the use of CRA to encourage solutions to several key consumer financial concerns, specifically, encouraging alternatives for homeowners facing mortgage foreclosures, meeting the need for affordable small-dollar loans, addressing the exceptionally high cost of credit and the need for basic banking services in many underserved communities.

Foreclosure Prevention

Between now and the end of 2008, subprime hybrid ARMs representing hundreds of billions of dollars in outstanding mortgage debt will undergo payment resets. Almost 1.3 million hybrid loans are scheduled to undergo their first reset during 2008,⁴⁶ and an additional 422,000 subprime hybrid loans are scheduled to reset in 2009. The combination of declining home prices and scarce refinancing options will stress these mortgage holders and could result in hundreds of thousands of additional mortgage foreclosures over the next two years.⁴⁷

⁴⁶ FDIC estimates based on the Loan Performance Securities Database. They reflect data collected through August 2007 on first-lien mortgages secured by owner-occupied properties where the mortgage has been securitized in private MBS issues. These figures have been adjusted to include an estimate of subprime securitized loans that are not included in the Loan Performance database.

⁴⁷ Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, on “Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement” before the Financial Services Committee, U.S. House of Representatives, December 6, 2007.

In April 2007, the federal financial regulatory agencies issued guidance encouraging financial institutions to consider prudent workout arrangements to keep borrowers in their homes,⁴⁸ and made clear that there may be favorable CRA consideration for programs to transition low- and moderate-income borrowers from higher cost to lower cost loans, provided the loans are made in a safe and sound manner.

Consistent with the April 2007 statement, the agencies have proposed revisions to several CRA Q&As to encourage institutions to work with homeowners who are facing foreclosures. The agencies have stated that they would view favorably for CRA purposes establishing loan programs that provide relief to low- and moderate-income homeowners facing foreclosure.⁴⁹

For banks or thrifts that are not direct lenders, or without the resources to offer refinancing programs, making investments in or loans to a lending consortium or a foreclosure prevention program, perhaps including financial counseling, may be a way to provide assistance to troubled borrowers and earn positive CRA credit. In several states, local lenders have already formed consortiums to provide rescue funds. Through one-on-one counseling, banks also can assist borrowers in understanding the terms of their existing loans and identifying potential problems, such as future resets. In addition, banks can provide borrowers with referrals to bona fide rescue programs they can trust,

⁴⁸ Statement on Working with Residential Borrowers, FIL-35-2007 (April 17, 2007), www.fdic.gov/news/news/financial/2007/fil07035.html.

⁴⁹ 72 Fed. Reg. 37922, 37939 (July 11, 2007).

such as Neighborworks' HOPE program and the HOPE NOW Alliance, all of which are activities viewed positively for CRA purposes.⁵⁰

Affordable Small-Dollar Loan Products

The current CRA regulations place emphasis on home mortgage, small business, and small farm loans. While these loans serve important needs, in recent years there has been tremendous demand for small-dollar loans, and a corresponding growth in high cost credit products, such as payday loans. These loans often trap borrowers in an unending cycle of debt as a result of annual percentage rates (APRs) of 300 percent or higher.⁵¹

The FDIC has encouraged banks to seek innovative ways to provide consumers with access to reasonably priced small-dollar loans and has used CRA incentives to further this effort. In 2007, the FDIC released its Affordable Small Loan Guidelines,⁵² which explore several aspects of product development, including affordability, streamlined underwriting and built-in savings components. FDIC examiners give favorable consideration to small-dollar loan programs consistent with these guidelines when evaluating CRA performance.

Also, the FDIC has approved a two-year pilot project to review affordable and responsible small-dollar loan programs in financial institutions. At the end of January,

⁵⁰ See FIL-35-2007, April 17, 2007, Working with Residential Borrowers.

⁵¹ See Preamble to Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 32 C.F.R. Part 232, 72 Fed.Reg. 50580 et seq. (August 31, 2007).

⁵² FIL-50-2007, June 19, 2007 <http://www.fdic.gov/news/news/financial/2007/fil07050.html>.

Chairman Bair launched this program with 30 volunteer banks of different sizes from across the country participating. The project is designed to assist bankers by identifying information on replicable business models for affordable small-dollar loans. Best practices resulting from the pilot will be identified and become a resource for other institutions.

Basic Banking Services

The FDIC also has started to explore using positive CRA consideration as an incentive for banks to offer products that build wealth and provide for financial security, such as individual retirement and health care accounts. In recent years, the FDIC has pursued a number of new initiatives to promote broader access to banking services by traditionally underserved populations and to ensure adequate consumer protection in the provision of these services.

The FDIC has formed an advisory committee -- the Advisory Committee on Economic Inclusion -- to explore in detail the kinds of incentives regulators currently provide to banks, and whether we can do more to encourage savings products. In addition, the FDIC has launched a new national initiative to form a network of local coalitions around the country charged with helping underserved communities gain access to federally insured institutions. This network -- the Alliance for Economic Inclusion -- is focusing on unbanked and underserved populations in nine markets across the country,

and is exploring ways to use CRA to improve access to banking services for these communities.

The FDIC has long recognized the importance of minority depository institutions in promoting the economic viability of minority and underserved communities. The FDIC relied on the CRA statute, absent any implementing regulations or guidance, to give positive CRA consideration for bank activities that support minority banks serving low- and moderate-income areas regardless of whether the minority bank is located in the supporting bank's assessment area.⁵³

High Cost of Credit

Recently, changes to the HMDA regulation⁵⁴ mandated the collection of certain pricing information on "higher priced" home mortgage loans beginning in 2004.⁵⁵ The HMDA pricing data has allowed researchers to see where, to whom, and by whom, these higher-priced loans -- an indicator of subprime and to some extent Alt-A lending -- are being made.

Patterns evident in these new HMDA data underscore questions about the scope of CRA and the way we evaluate the credit services provided by banks, particularly mortgage loans. While credit has become more available, a smaller percentage is subject

⁵³ Pursuant to a 1992 amendment to CRA, *see* 12 U.S.C 2907. See also recently proposed Q&A on investments in minority- or women-owned financial institutions and low-income credit unions in. 72 Fed. Reg. 37922. 37924 (July 11, 2007).

⁵⁴ *See* 12 C.F.R. Part 203.

⁵⁵ *See* 12 C.F.R. § 203.4(a)(12).

to CRA evaluation. In recent years, independent mortgage companies, particularly those focused on subprime lending, have made an increasing share of home loans. CRA does not apply to their activities. Insured depository institutions increasingly lend outside of the areas where they operate branches, and sometimes do this through affiliated entities, which are only included in the evaluation at the institution's option. In the most recent HMDA pricing data available, 19 percent of the conventional first lien mortgage loans originated by depository institutions were higher-priced, compared to 23 percent by bank subsidiaries, 38 percent by other bank affiliates, and more than 40 percent by independent mortgage companies.⁵⁶ Moreover, loans extended within banks' CRA assessment areas were less likely to be higher priced than loans originated outside of banks' assessment areas.⁵⁷

These patterns raise questions about what should constitute a bank's assessment area and whether only lending within the assessment area should be considered. They also raise questions about whether continuing to cover only banks and thrifts under CRA is achieving the goals established by CRA thirty years ago -- that is, to work towards meeting the credit needs of entire communities. These patterns highlight the importance of focusing attention on not just whether loans are being made but also at what price and by whom, particularly with regard to minority borrowers, as highlighted consistently by the HMDA data, and as similarly evidenced by the cost of many short-term, small-dollar loan products.

⁵⁶ Avery, Brevoort, Canner, The 2006 HMDA Data, Federal Reserve Bulletin, December 2007, at A89.

⁵⁷ *Id.* at A75.

Conclusion

Because Congress wrote the CRA in a way that allowed for adaptation to changing conditions over the years, the statute has been highly flexible and CRA, through the implementing regulations, has evolved significantly over the thirty years since enactment. As credit has become available more broadly to low- and moderate-income borrowers and neighborhoods, significant progress has been achieved toward meeting the original goals of the legislation.

Yet, there continue to be areas where CRA could have an important impact on the business activities of banks and thrifts. Through periodic revisions of the regulations, and regularly updated guidance, the agencies address evolving financial needs in communities. Today those needs include basic banking services, savings programs, affordable small-dollar loans, and foreclosure prevention programs. CRA's flexibility ensures that it will continue to enhance the ability of all consumers to access and benefit from our banking system.

Thank you for the opportunity to testify today. I look forward to answering any questions.